

Pension Protection Act of 2006

President Signs Pension Protection Act of 2006

On August 17, 2006, President Bush signed the Pension Protection Act of 2006, H.R. 4, which was overwhelmingly approved by the House of Representatives and the Senate. The Act is one of the most far-reaching revisions of pension laws in the last 30 years. The Act revises single-employer and multiemployer pension funding rules for defined benefit plans, changes many cash balance and defined contribution plan rules, and liberalizes the investment advice rules. The Act also makes permanent the EGTRRA provisions that were scheduled to expire after 2010. Many provisions of the Act are effective upon enactment, which is August 17, 2006.

Reform of Minimum Funding Requirements for Defined Benefit Plans

The Act completely replaces the current minimum funding requirements of the Code and ERISA. Most of the new requirements will be effective as of the plan year beginning in 2008. (The current minimum funding rules will remain in effect for plan years beginning in 2006 and 2007.) However, the Act contains numerous transition rules and special effective dates. Basically, it toughens the funding arrangements for defined benefit plans.

- **At-Risk Plans** – If a plan is considered “at risk” (*e.g.*, less than 80% funded) for a year, based on the value of the preceding plan year’s assets, the plan is subject to accelerated funding requirements. Plans with 500 or fewer participants are exempt from this requirement.

- **Contribution Deadlines** – The due date for the payment of minimum required contributions is generally 8½ months after the close of the plan year. The payment must be increased with interest to reflect the span of time between the valuation date (generally the first day of the plan year) and the date payment is actually made. If the plan has a funding shortfall for the preceding plan year, quarterly contributions are required. If a plan sponsor does not make timely contributions and the amount of the contributions exceeds \$1 million, then a lien is imposed on all the property of the sponsor and the members of its controlled group.
- **Benefit Restrictions** – The Act expands the restrictions on plan amendments, accruals and distribution options if a plan is severely under funded (in most cases less than a 60% or 80% level) or if the employer is in bankruptcy.
- **Variable Rate PBGC Premiums** – In an effort to shore up the PBGC, the Act repeals the current full funding exception effective for plan years beginning in 2008.

Reporting and Disclosure Changes

- **Defined Benefit Plan Funding Notices** – Section 501 of the Act amends ERISA to provide that the administrator of a defined benefit plan (*regardless of the plan's funding status*) is required to provide a plan funding notice each plan year to the PBGC and to each participant and beneficiary for plan years beginning after 2007.
- **Benefit Statements** – The Act requires benefit statements to be provided once per quarter for a participant-directed individual account plan, annually for all

other individual account plans, and once every 3 years for a defined benefit plan. This requirement applies to plan years beginning after 2006.

Fiduciary Rules and Investment Advice

- **Investment Advice** – Section 601 of the Act amends ERISA and the Code to provide a prohibited transaction exemption for certain investment advice that is provided to a participant in an individual account plan. (This provision does not cover advice given to a plan fiduciary.) The advice must be provided by a “fiduciary advisor” pursuant to an “eligible investment advice arrangement” (as defined below). The arrangement must also be approved by an independent fiduciary and certain disclosures to participants must be made. A plan sponsor is treated as having met its fiduciary duties under Part 4 of ERISA, if the above requirements are satisfied. This provision applies to advice provided after December 31, 2006.

- **Eligible Investment Advice Arrangement** – This is an arrangement which either provides that any fees received by the fiduciary advisor from the participant do not vary depending on the investment option selected by participants or the advisor uses a computer model that meets certain requirements. If the advisor uses the computer model, no other advice, including personal advice, can be provided in addition to what the computer model provides.

Cash Balance and Similar Plans

- **Prospective Clarification Regarding Age Discrimination** – The Act supports cash balance plans prospectively by providing that a plan is not age discriminatory if a participant's account balance, determined as of any date under the plan, is at least as great as that of any similarly situated, younger participant. Full vesting must occur no later than when a participant has 3 years of service.

EGTRRA Permanency

EGTRRA made a number of changes affecting retirement plans and individual retirement accounts. These provisions were scheduled to expire after December 31, 2010, with the exception of the Saver's Credit, which was due to expire after 2006. The Act removes these expiration dates, making virtually all retirement plan-related EGTRRA changes permanent. These changes include the following:

- Increased benefit and contribution limits
- Permitting 401(k) account Roth designations
- Catch-up contributions if age 50 or over
- Tax deduction for ESOP reinvested dividends
- Deferrals disregarded from deduction limits
- Enhanced rollover opportunities
- Repeal of 457 plan coordination requirements
- Repeal of the ADP / ACP multiple use test

401(k) Operations and Investment Revisions

- **Employer Security Diversification** – Section 901 of the Act provides that a defined contribution plan must allow participants to diversify the investment of elective deferrals and employer contributions out of employer stock. However, plans may require a participant to complete 3 years of service before allowing the investment of employer contributions to be diversified out of employer stock. This requirement only applies to plans with publicly traded employer stock (as defined by the Act). This requirement is effective January, 1, 2007, with a three-year, phased-in transition rule for existing plans.
- **New Automatic Enrollment Safe Harbor** – Effective for plan years beginning after December 31, 2007, Section 902 of the Act provides for a new automatic enrollment safe harbor. In order to meet the safe harbor, a plan must have an automatic enrollment percentage based on the employee's year of participation (at least 3%, but no more than 10%), with the enrollment percentage automatically increasing as the employee's years of participation increase. The plan also must provide a matching contribution of 100% on deferrals up to the first 1% of compensation and 50% on deferrals up to the next 5%, or a 3% nonelective contribution. Matching and nonelective contributions must be fully vested after two years. Plans that satisfy the requirements would be deemed to satisfy the ADP test and would not be subject to the top-heavy rules. (Certain additional rules must be followed to satisfy the ACP test.) Effective as of

the date of enactment, the Act also amends ERISA to preempt any state laws (*e.g.*, wage withholding laws) that would prohibit or restrict a plan sponsor from adding an automatic enrollment feature, but only if the employer meets the notice requirements of the Act. Current employees who have made an election, even if it was an election not to participate whether affirmative or default, do not have to be included, but the employer could include these employees if it desired. This new provision provides a safe harbor for those employers who desire to follow the safe harbor rules, but employers are still free to adopt a non-safe harbor automatic enrollment provision.

Portability, Distribution and Contribution Revisions

- **Faster Vesting** - Section 904 of the Act applies the faster vesting rules of EGTRRA for matching contributions (3-year cliff or 6-year graded) to *all contributions to a defined contribution plan*. This applies to contributions made for plan years beginning after December 31, 2006.
- **Roth IRA Direct Rollovers** – Effective for distributions after December 31, 2007, retirement plan distributions may be rolled directly into a Roth IRA, subject to the regular Roth IRA conversion rules (including eligibility limits based on adjusted gross income). The taxable portion of the distribution would be taxed at the time of the rollover.
- **Hardships and Unforeseen Financial Emergencies** – Section 826 of the Act instructs the Service to modify (within 180 days after enactment) the 401(k) and

403(b) hardship regulations to provide, if the plan so elects, for a hardship distribution to a participant's beneficiary (even if the beneficiary is not a spouse or dependent).

Plan Amendments

The Act requires plan amendments relating to the Act to be made by the last day of the first plan year beginning on or after January 1, 2009.